

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>2101 DINER CORP. D/B/A SUFFOLK DINER</b>	:	
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period September 1, 2005 through May 31, 2007.	:	
<hr/>		DETERMINATION
		DTA NOS. 822271 AND 822329
In the Matter of the Petition	:	
of	:	
<b>GEORGE REKKAS</b>	:	
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period September 1, 2005 through May 31, 2007.	:	

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Petitioner 2101 Diner Corp. d/b/a Suffolk Diner filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 2005 through May 31, 2007.

Petitioner George Rekkas, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 2005 through May 31, 2007.

A consolidated hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 23, 2009 at 10:30 A.M., with all briefs to be submitted by September 14, 2009, which date

began the six-month period for the issuance of this determination. Petitioners appeared by Paul Kalker, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Lori P. Antolick, Esq., of counsel).

### ***ISSUES***

I. Whether 2101 Diner Corp. d/b/a Suffolk Diner (petitioner<sup>1</sup>) produced, upon request by the Division of Taxation (Division), adequate books and records for the performance of a detailed audit.

II. If not, whether the audit method employed by the Division of Taxation was reasonably calculated to reflect tax due or whether petitioner has shown error in either the audit method or the amount of the assessment resulting therefrom.

III. Whether petitioner has established any facts or circumstances warranting abatement of penalties imposed by the Division.

### ***FINDINGS OF FACT***

1. During the period at issue herein, petitioner operated a diner known as the Suffolk Diner in Centereach, New York. It ceased operation in or about March 2007, at which time the business was sold.

2. The auditor mailed an appointment letter with an attached Records Requested List to petitioner on February 13, 2007. The letter indicated that the audit period was September 1, 2005 through November 30, 2006. Petitioner's representative requested a postponement of the appointment.

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<sup>1</sup> Petitioner George Rekkas was assessed as an officer or responsible person of 2101 Diner Corp. At the hearing held in these matters, it was conceded by petitioners' representative that Mr. Rekkas was an officer or responsible person of the corporation. Therefore, unless otherwise noted, the term "petitioner" shall refer to 2101 Diner Corp.

On March 28, 2007, the auditor mailed another appointment letter (with attached Records Requested List) to petitioner which expanded the audit period to include the period December 1, 2006 through February 28, 2007. When petitioner's representative called to cancel the appointment, another letter was sent on April 25, 2007 that scheduled an audit for May 8, 2007. On May 3, 2007, after receiving a telephone call from petitioner's representative, the auditor picked up petitioner's records, which consisted of sales tax returns, 2005 and 2006 federal income tax returns, cash disbursements journal and one bank statement. Guest checks, cash register tapes and expense purchase invoices for the audit period were not provided to the auditor.

Subsequently, on May 8, 2007, the representative informed the auditor that petitioner was no longer in business. The auditor then visited the business premises and spoke with a person who identified himself as the new owner and manager who took over from petitioner on March 26, 2007. As a result of this conversation, the auditor decided to again update the audit period to include the final sales tax quarter in which petitioner was in business, i.e., March 1, 2007 through May 31, 2007. Additional appointment letters and records requests were sent on May 10, 2007, May 29, 2007 and June 11, 2007. No additional books and records were provided to the auditor.

3. Because the auditor determined that the records provided by petitioner were inadequate for the performance of a detailed audit, he selected an audit method which related credit card receipts to total receipts.

Since complete bank statements were not made available, the auditor subpoenaed petitioner's bank records from HSBC Bank. From the bank statements received, the auditor was able to determine whether the deposits were cash or, if a credit card deposit, the type of credit

card used, i.e., Visa, MasterCard, American Express or Discover Card, and the amounts deposited.

To the credit card receipts, the auditor added a settlement fee, which is the fee charged by the credit card company to the taxpayer. These fees were determined by using percentages derived from other audits performed by the Division. The fees varied for each credit card company and ranged from 1.5% for Discover Card to 2.9% for American Express. For the audit period, total credit card receipts, including settlement fees, were \$1,660,770.06.

4. At the time of this audit, the auditor was also auditing a similar diner located in Bohemia, New York. During his 24 years with the Division, the auditor had conducted between 350 and 480 sales tax audits. He indicated that in the last few years, he had audited four or five diners including a diner that had operated at the same location as petitioner. For each of the diners which he audited, the auditor utilized the credit card percentage audit method.

Because petitioner was out of business at the time of the commencement of this audit, the auditor obtained a menu from the new operator of the diner that succeeded petitioner at the Centereach location and compared the menu to that of the diner in Bohemia, New York, which, the auditor testified, had nearly identical pricing as well as a similar location with comparable business traffic. The auditor indicated that in his experience, similar pricing was the primary factor in determining the method of payment, i.e., whether the patrons paid in cash or by credit card. In addition, since petitioner and the Bohemia, New York, diner were in similar locations, the auditor indicated that “we assume the same type of people live [there].”

The Division introduced into evidence, as part of the audit workpapers, a Nassau/Suffolk Diner Database which set forth a listing of 25 diners with audit periods commencing from December 1996 through June 2003. Among the information provided in this listing was the

credit card percentage of 23 of the 25 diners listed thereon. The credit card percentages ranged from a low of 2.11% (the next lowest percentage was 14.94%) to a high of 48.36%. The average credit card percentage of all of the diners listed was 27.268%. Of the 17 diners with gross sales per quarter of less than \$400,000.00 (petitioner was in this category), the average credit card percentage was 24.879%. The auditor indicated that the lower the credit card percentage, the higher the assessment of additional tax due.

Due to the auditor's conclusion that the Bohemia diner was similar to petitioner's operation, an observation test<sup>2</sup> of the Bohemia diner was utilized whereby the auditor computed the percentage of credit card receipts for the one day, i.e., every sale was recorded and at the end of the day, a percentage of credit card receipts to total receipts was calculated.

To determine net credit card receipts, it was necessary to deduct tips from the credit card revenue. The tips percentage (the percentage of tips from credit card receipts) was also calculated from the observation test of the Bohemia, New York diner. This tips percentage was computed to be 5.98%. The credit card percentage (credit card receipts excluding tips divided by total receipts) was found to be 30.20%.

5. From petitioner's subpoenaed bank statement, the auditor calculated petitioner's total credit card revenue (including settlement fees) to be \$1,660,770.06 for the audit period. By applying the tips percentage of 5.98% obtained from the audit of the Bohemia diner, petitioner's net credit card receipts were determined to be \$1,561,479.13. The net credit card receipts were then divided by the credit card percentage determined from the audit of the Bohemia diner (30.20%) to arrive at total audited receipts of \$5,170,460.69. Sales tax of \$410,542.91 was

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<sup>2</sup> The auditor indicated that while he was not personally involved in the conduct of the observation test, the test was conducted by other members of his office staff. The auditor did, however, review all of the records, such as guest checks, utilized in the observation test.

deducted, thereby resulting in audited taxable sales of \$4,759,917.78. Petitioner had reported taxable sales of \$1,918,233.00 for the audit period, which was subtracted, leaving a balance of \$2,841,684.78 in additional taxable sales. Tax due thereon was determined to be \$245,095.31.

6. Accordingly, on September 10, 2007, the Division issued a Notice of Determination to petitioner assessing additional sales tax in the amount of \$245,095.31, plus penalty and interest, for a total amount due of \$352,371.83 for the period September 1, 2005 through May 31, 2007.

On September 13, 2007, the Division issued a Notice of Determination to George Rekkas as an officer or responsible person of petitioner assessing tax in the amount of \$245,095.31, plus penalty and interest, for a total amount due of \$352,692.45, for the period September 1, 2005 through May 31, 2007. As previously noted, at the hearing held in this matter, it was conceded that George Rekkas was, in fact, an officer or responsible person of petitioner.

7. At a conciliation conference held by the Division's Bureau of Conciliation and Mediation Services, petitioner provided information to the conciliation conferee that indicated that the settlement fees for Visa, MasterCard and Discover Card, which had been included in the auditor's computations (*see* Finding of Fact 3), had already been paid by petitioner and, therefore, should not have been added by the auditor. For American Express Card sales, the settlement fees for periods prior to August 1, 2006 should also have been excluded from the auditor's computations. Accordingly, the conferee determined that total credit card revenue should have been \$1,626,683.45 rather than \$1,660,770.06 as originally computed, with the result being that additional taxable sales were \$2,743,989.46 (instead of \$2,841,684.78 as initially computed by the auditor), with tax due thereon in the amount of \$236,669.09.

8. The Division introduced into evidence a listing of other audits conducted at the Suffolk diner location. An audit of Cronos Enterprises, Inc., was conducted for the period March 1, 2001

through November 30, 2003 and an audit of Parnasos, Inc., was conducted for the period March 1, 2004 through November 30, 2005, in addition to the audit at issue in this matter.

The auditor in the present matter also conducted the audit of Parnasos, Inc., and he employed the same audit method for both audits, which included utilization of the observation test conducted at the Bohemia, New York, diner. Petitioner's representative also represented Parnasos, Inc., during its audit.

### ***SUMMARY OF PETITIONERS' POSITION***

9. Petitioners allege that the audit method employed by the Division was arbitrary and capricious. The auditor, in computing the percentage of credit card receipts versus total receipts, chose to apply the actual percentage from one particular diner as opposed to an average of several diners. In addition, the record does not contain specific information concerning the diner that the auditor chose as the comparable diner. Even if the menu pricing of the allegedly comparable diner was similar, or even if identical to that of petitioner's diner, it has no correlation with a diner's percentage of credit card sales to total taxable sales.

### ***CONCLUSIONS OF LAW***

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "[a] sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i]).

B. Tax Law § 1135(a) provides that "[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require."

20 NYCRR 533.2(b)(1) provides that the records which are required to be kept must contain a true copy of each:

(i) sales slip, invoice, receipt, contract, statement or other memorandum of sale;

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(iii) cash register tape and any other original sales document.

In the present matter, there is no dispute that petitioner did not furnish, upon numerous requests by the auditor, books and records sufficient for the performance of a detailed audit. Source documents such as guest checks, cash register tapes and expense purchase invoices were not provided to the auditor.

C. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, “or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . .” (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

D. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.*, as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858]) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the



examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Ligs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is “virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit” (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), “from which the exact amount of tax due can be determined” (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Ligs. v. State Tax Commn.*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150 [1957], *cert denied* 355 US 869, 2 L Ed 2d 75 [1957]), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176 [1976], *affd* 44 NY2d 684, 405 NYS2d 454 [1978]; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113 [1986]) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451 [1981]; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, “[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case” (*Matter of Grecian Sq. v. Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221 [1986]).

E. Having established the insufficiency of petitioner's books and records, the Division was entitled to resort to an estimate based on the auditor's audit experience to determine its taxable sales (*see Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance*, 206 AD2d 989, 613 NYS2d 967 [1994]; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, 589 NYS2d 102 [1992]). And, as pertains to the matter at issue, it has been held on numerous occasions that the Division may resort to estimates based on experience derived from audits of similar business (*see e.g. Matter of Oak Beach Inn Corp. v. Wexler*, 158 AD2d 785, 551 NYS2d 375 [1990]; *Matter of Hanratty's/732 Amsterdam Tavern, Inc. v. New York State Tax Commn.*, 88 AD2d 1028, 451 NYS2d 900 [1982], *appeal dismissed* 57 NY2d 954, 457 NYS2d 1028 [1982]). Clearly, therefore, the only remaining issue is whether petitioner has established that the amount of tax assessed as the result of this audit was erroneous.

F. Petitioner argues that the audit method utilized in this case was arbitrary and capricious because, in computing the percentage of credit card receipts versus total receipts, the auditor chose to apply the actual credit card percentage from one particular diner rather than apply an average of several diners. Petitioner's argument is without merit.

First, it must be noted that in arriving at the additional taxable sales and resulting additional sales tax due herein, the auditor applied the credit card percentage derived from his audit of a similar diner to petitioner's own receipts for the audit period. The records pertaining to petitioner's receipts (including credit card receipts) were not furnished to the auditor by petitioner but, instead, were obtained by means of a subpoena. The credit card percentage was calculated from an observation test conducted by the Division at the Bohemia, New York, diner. As stated in Finding of Fact 4, had the auditor applied an average credit card percentage of all of the diners audited in Nassau and Suffolk counties during the relevant period, such percentage

(24.879% for diners similar to petitioner or 27.268% for all diners) would have been lower than the 30.20% percentage actually utilized in the present matter and the result would have been a greater assessment than the amount assessed against petitioner.

As to petitioner's contention that the record does not contain enough specific information about the diner that the auditor chose as the comparable, that, too, is without merit. The auditor indicated that the diner was located in Bohemia, New York, a nearby community. He stated that he obtained a menu from the new operator of the diner that succeeded petitioner at the Centereach location and that the prices were nearly identical to the prices on the menu at the Bohemia diner. The auditor also indicated that the Bohemia diner had a location similar to that of petitioner with comparable business traffic. Short of disclosing the actual name, address and audit information of the Bohemia diner, which would have been in violation of the secrecy provisions of the Tax Law, the auditor's testimony was sufficiently detailed and his answers to questions posed by petitioner's representative were sufficiently responsive to not deprive petitioner of the opportunity to pursue an effective cross examination. Accordingly, because petitioner has presented no source documentation whatsoever that could substantiate its taxable sales for the audit period or refute the audit findings, it must be found that petitioner has failed to sustain its burden of proving, by clear and convincing evidence, that the assessment was erroneous.

G. Finally, petitioner contends that penalties assessed herein should be abated. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). In the present matter, it is clear that petitioner failed to keep and produce upon request on audit, adequate records of its sales. As the Tax Appeals Tribunal has noted, on numerous occasions, the failure to maintain and provide

records is a reason to sustain the imposition of penalties (*Matter of Rosemellia*, Tax Appeals Tribunal, March 12, 1992; *see also Matter of Shukry v. Tax Appeals Tribunal*, 184 AD2d 874, 585 NYS2d 531 [1992]). Penalties are, therefore, sustained.

H. The petitions of 2101 Diner Corp. d/b/a Suffolk Diner and George Rekkas are denied and the notices of determination issued to petitioners on September 10, 2007 and September 13, 2007, respectively, are hereby sustained.

DATED: Troy, New York  
March 11, 2010

/s/ Brian L. Friedman  
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ADMINISTRATIVE LAW JUDGE